



October 2007

Climate change focus

Forestry in the front line

The Government's "climate change solutions", released late last month, have identified the forestry sector as the first battlefield in New Zealand's war against increasing greenhouse gas emissions. Indeed, it appears as though there will be a multi-faceted strategy in relation to forestry, including the emissions trading scheme (ETS), to reduce greenhouse gas emissions from this sector and, more generally, to meet New Zealand's international commitments under the *Kyoto Protocol*.

Other climate change reduction proposals for the forestry sector include the existing Permanent Forest Sink Initiative (PFSI) and the East Coast Forestry Project (ECFP). In addition, the Government proposes to launch a new Afforestation Grant Scheme (AGS) in December 2007, for planting in winter 2008.

Whilst the inclusion of forestry in the proposed ETS, and the consequent granting of credits and liabilities to landowners, marked a change from the Government's previous rhetoric, the key question of the forestry sector is how the implementation of the climate change solutions outlined by Government will actually impact upon the sector. In some instances, there will be benefits, in others instances, losses. It will therefore be very important for the sector to fully appreciate such impacts.

The real effect of the Government's climate change initiatives on forestry sector participants will be difficult to forecast before the solutions are actually implemented. Indeed, the roll-out of the Government's proposals in the forestry sector is scheduled to occur quite quickly, so there may be little time for detailed analysis. In addition, available information on the Government's proposals lacks detail to date; leaving many operational questions unanswered.

The tight timeframe for implementation of proposals and absence of operational detail at the outset also mean the Government is likely to learn as it goes. Whilst this means that the Government will probably capitalise on its experience in the forestry sector as other sectors in the economy start to

participate in the ETS, it also means that the forestry sector will essentially be the Government's testing ground for the ETS.

Why forestry?

Forestry has a significant impact on global atmospheric carbon levels. Trees absorb carbon dioxide from the atmosphere as they grow and store this carbon in their biomass (including tree trunks, branches, foliage and roots). Storage of carbon dioxide in trees assists the process of carbon sequestration – the long-term storage of carbon in terrestrial ecosystems, geological formations and the ocean.

When trees are cut down, stored carbon dioxide is released back into the atmosphere. In this way, deforestation, the felling of forests without replacement of trees and conversion of previously forested land to another land use, can be a major source of greenhouse gases. (The Government's general definition of "deforestation" is "the conversion of forested land to non-forest uses, such as farmland, roads, or housing developments").

Given forestry's central role in managing New Zealand's carbon footprint, early implementation of well-considered measures in the forestry sector is imperative. So what exactly does the Government propose?

The dynamics of the ETS for forestry

The Government's primary climate change solution is an ETS covering all greenhouse gases and all sectors. Forestry is scheduled to be the first sector in the New Zealand economy to operationalise the ETS (on 1 January 2008). While a lot of the details in relation to the precise operation of the ETS have still to be fully developed, a range of features can be distilled from documentation released thus far.

Without doubt, the most significant (and potentially controversial feature) of the proposal for forestry under the ETS is the differential treatment of forests based on their date of establishment. Exotic forests established after 31 December 1989 are “Kyoto” or “post-1989” forests. Exotic forests that already existed as at 31 December 1989 are coined “non-Kyoto” or pre-1990 forests. The rationale for this distinction is that it reflects the international rules for determining the New Zealand Government’s credits and liabilities under the Kyoto Protocol.

Pre-1990 forest

The Government has indicated that landowners will incur liabilities for the release of carbon dioxide arising from deforestation of pre-1990 forests. Recognising the significance of this liability, the Government will issue landowners of pre-1990 forests with free New Zealand Units (NZUs) which can then be traded on the emissions market.

Although owners of pre-1990 exotic forests who decide to deforest after 1 January 2008 will be automatically liable for the carbon emitted as a result of the deforestation; their receipt of NZUs will not be automatic. Owners of pre-1990 forest wishing to receive an allocation of NZUs will have to apply to the administering agency for that allocation within 18 months of the passage of the ETS legislation.

NZUs will be allocated to owners of pre-1990 forests on the basis of the size of their forests. The Government has given a rough indication of the timing of these allocations. Owners of forests that are closest to harvesting age will receive the first allocation of NZUs in 2008/2009. Two further blocks of NZUs will be allocated to owners of young and middle-ages forests in 2008/2009. But these NZUs will be post-dated so that they cannot be used until the trees are closer to harvesting age.

The inclusion of indigenous (native) forests established prior to 1990 in the ETS is far from clear. The Government is seeking public feedback on this question. A preliminary suggestion is that if these forests are included in the ETS, owners will receive NZU credits at a lower rate than the allocation for pre-1990 exotic forests.

The Government proposes a separate regime for pre-1990 forest on Crown land which distinguishes between Crown forest land subject to a Crown Forest Licence (CFL) and land administered by public authorities. Practically, land under a CFL cannot be deforested until the CFL expires so the effect of the ETS will be delayed in many cases. The Government will allocate notional credits for all land under a CFL so that the units are available in the event of a Treaty claim for the land.

All owners of pre-1990 forests will automatically fall within the ETS, but exemption provisions will enable some pre-1990 forest owners to avoid participation in the ETS. Owners of pre-1990 may apply for an exemption if:

- the forest is less than 50 hectares total area
- the landowner deforests less than two hectares of their pre-1990 forest, or
- the landowner removes weed trees such as wilding pine.

Post-1989 forest

In principle, the Government has elected to give owners of post-1989 forests the choice to enter the ETS and receive all of the corresponding credits and liabilities.

Owners of post-1989 forest will have 18 months from the passing of the ETS legislation to decide to join the scheme. Forest owners wishing to join the scheme after this date will have to wait until after 2012 to join.

Owners who enter the ETS will assume responsibility for the ongoing net changes in the carbon stocks of their forests. “Carbon stock” refers to the total volume of carbon dioxide stored in a forest at any point in time. Owners of post-1989 forests who enter the scheme will gain NZUs for increased carbon stocks, but will be required to surrender NZUs if carbon stocks decrease through a temporary reduction in forest or deforestation.

The Government will retain the credits and liabilities of those post-1989 forest owners who do not opt into the ETS.

Associated Costs

Owners of post-1989 forest will need to undertake a thorough cost-benefit analysis before deciding whether to enter the ETS. In addition to potential, if not inevitable, liability for decreases in carbon stocks, participants in the ETS will be subjected to numerous compliance costs. Owners will have to pay registered carbon certifiers to calculate the carbon stock in their forest and meet other costs associated with reporting.

The Government has also indicated that the direct costs associated with administration of the scheme will be passed onto forest owners participating in the ETS. The aggregate of compliance and administrative costs could discourage post-1989 forest owners from joining the scheme, particularly those with relatively small forests.

The significance of species

Indigenous forest and the ETS

Estimates of carbon emissions for New Zealand’s indigenous and exotic forests must be reported to the United Nations

under the Kyoto Protocol. Scientists are presently researching whether the decay of native trees is adding to New Zealand's carbon emissions and developing tools to predict carbon emissions from native trees.

Variation in carbon storage capacity between species

Preliminary estimates of carbon sequestration released by the Ministry of Agriculture and Forestry (MAF) show a significant variation in the carbon sequestration capacity between species. For example, the carbon stock for Radiata Pine on a high productivity site is estimated at 814tCO₂/ha compared with an carbon stock estimate of 1290tCO₂/ha for mature Beech-Podocarp forest. As long as MAF's preliminary data is within the ball park of actual carbon sequestration rates, one could confidently predict that variation in species' ability to sequester carbon will have significant economical and ecological ramifications.

Owners of forests planted with high-carbon sequestering species may have the potential to gain more through the ETS than their counterparts who own forests of low-carbon sequestering species. Of course, other potential biological characteristics of these species, such as slow growth rates and low resilience, as well as the commercial value of timber resources may off-set the economic advantage of the species' high carbon-content. Without delving into research on all of these factors, it is clear that species choice will grow in economical significance following the advent of the ETS in the New Zealand forestry sector.

Economic choices can have profound ecological effects. Increasing focus on the economic appeal of forest tree species could result in significant changes in New Zealand ecology, and consequently, our overall biodiversity. Whether these changes will be beneficial to New Zealand is, however, a matter for research and further consideration.

A taxing problem

Tax implications will be another factor to be weighed by post-1989 forest owners when deciding whether to opt into the ETS. Owners of pre-1990 forests will also need to consider the down-stream tax consequences of their forest management and any contemplated change in land use. In this regard, the Government has recently released an Issues Paper on tax matters arising from the ETS – [click to see attached link](#).

Core tax issues that will have to be dealt with include the general tax treatment of emissions obligations, the consequences of free allocation of emissions units, and the timing of recognition of income and expenditure. Submissions from the forestry sector on the issues arising from this paper should be made by **28 October 2007**.

Afforestation Grant Scheme

In addition to the ETS, the AGS is set to be another weapon in the Government's armoury against climbing greenhouse gas emissions. The essential concept of this scheme is that participants will receive a government grant for the planting of new forests on previously unforested land.

Participants will own the new forests and earn income from the timber, while the Government will accrue the associated carbon credits and take responsibility for meeting all harvesting and deforestation liabilities.

The Government has not given any indication of the value of the proposed grants. Most of the operational detail around the allocation of grants is yet to be disclosed. Government documentation does, however, reveal an intention to grant funds under the following two categories:

- exotic forests, and
- planted indigenous forests and assisted indigenous reversion (which could involve the establishment of exotic trees as nurse crops for native species).

Candidates wishing to receive an AGS grant will need to apply through a competitive tender process. Biannual tender rounds for each category have been suggested, with the first tender round potentially closing in December 2007 for planting in winter 2008.

The Government has suggested that the AGS might be particularly attractive to owners of small forests who have less capacity to deal with the participation costs of the ETS. The Government has not, however, substantiated this suggestion with estimates of actual compliance costs under either scheme.

Forestry has a key role to play

Forestry clearly has a leading role to play in climate change. Whether the sector aids or impinges the fight against greenhouse gas emissions in the long-term will depend greatly on the Government's ability to harness the capacity of forests to offset the detrimental affect of emissions through an appropriate regime.

Early implementation of the proposed ETS in the forestry sector is without doubt a step in the right direction. However, as always, the devil is in the detail. Available information on the Government's proposals leaves many questions unanswered and exposes gaps in the battle plan. The Government will have to make wise choices when resolving these issues.

How do I find out more?

The foregoing is just a snapshot of what is being proposed for the forestry sector; it attempts to capture the essence of what the Government has put on the table. The integrated team at Minter Ellison Rudd Watts comprises exceptional lawyers with expertise in sustainability, climate change, forestry and New Zealand's business environment. They can advise on all aspects of sustainability and climate change issues, including how your interests can most effectively be managed, advanced and addressed under the recently announced package of initiatives.

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